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# **Tennessee Education Lottery**

## **Revenue Estimates**

### **(Fiscal Years 2006-07 and 2007-08)**

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**Presented to: The State Funding Board**

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# Presentation Outline

- FY2005-2006 Actual
- Revenue Sources
- Trends - Expenses & Net Lottery Proceeds
- Assumptions
- FY06-07 Estimates (as of May 3, 2006)
- FY06-07 Estimates (Revised)
- FY07-08 Estimates (New)

# FY2005-2006

## Actual

## FY05-06 Actual

- Gross Ticket Sales: \$996.3 million
  - Tickets given as prizes: (\$68.3 million)
  - Net Ticket Sales: \$928.0 million
  - Misc. Revenues: \$5.4 million
  - Total Net Revenues: = \$933.4 million
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- Prize Expense: \$545.7 million
  - Other Gaming Expenses: \$102.4 million
  - Operating Expenses: \$15.5 million
  - Total Expenses: = \$663.6 million (71.1%)
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➤ Net Lottery Proceeds: = \$269.8 million (28.9%)

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# Revenue Sources

# FY05-06 Sales Revenue Growth

Revenue Source	Net Sales FY04-05	Net Sales FY05-06	Dollar Growth	Percent Growth	Share of Overall Growth
Instant Games	\$538,345,177	\$627,952,797	\$89,607,620	16.6%	62.1%
CASH 3 & CASH 4	\$75,280,740	\$86,949,055	\$11,668,315	15.5%	8.1%
Lotto 5	\$23,398,661	\$22,155,487	-\$1,243,174	-5.3%	-0.9%
Powerball	\$146,674,142	\$190,947,513	\$44,273,371	30.2%	30.7%
	\$783,698,720	\$928,004,852	\$144,306,132	<u>18.4%</u>	100.0%

# Instant Games

- Generated 67.7% of net sales in FY05-06.
- FY05-06 Growth: 16.6%
- FY06-07 Expectation: Slightly more moderate growth.
- Expected Growth Range: 8.5% to 10.5% range.
- July thru November (2006) sales are up about 11.2% (relative to the same time period in 2005).
- Growth is being driven by increasing prize payout structures over time.
- Due to law of diminishing returns, less growth is expected this year.

# CASH 3 and CASH 4

- Generated 9.4% of net sales in FY05-06.
- FY05-06 Growth: 15.5%
- FY06-07 Expectation: slight growth to marginal growth.
- Expected Growth Range: 2.0% to 4.4% range.
- July thru November (2006) sales are up about 5.2% (relative to the same time period in 2005).
- Majority of last year's growth should be seen as “one-time” growth.
- Introduction of mid-day drawings (Nov. 2005).
- FY05-06 was first year CASH 4 considered a mature game.
- Result: over-stated growth rate...growth was not from natural growth.



# LOTTO 5

- Generated 2.4% of net sales in FY05-06.
- FY05-06 Growth: (-5.3%)
- FY06-07 Expectation: very good growth.
- Expected Growth Range: 18.8% to 24.3% range.
- Sales growth is highly dependent upon jackpot growth.
- Last year's sales decline is attributable to negative jackpot growth.
- Average jackpot: FY04-05 = \$224,100; FY05-06 = \$153,300
- Average jackpot declined by 31.6%.
- So far this FY the jackpot has averaged \$237,200; a 54.7% increase.
- As a result, sales have been up.
- July thru November (2006) sales are up about 33.6% (relative to the same time period in 2005).
- Will it continue? Depends on the jackpots!

# POWERBALL

- Generated 20.6% of net sales in FY05-06.
- FY05-06 Growth: 30.2%
- FY06-07 Expectation: Negative growth.
- Expected Growth Range: (-15.0%) to (-2.0%) range.
- Sales growth is highly dependent upon jackpot growth.
- Last year's extraordinary sales growth is attributable to significant jackpot growth.
- Average jackpot: FY04-05 = \$49.8 million; FY05-06 = \$82.3 million.
- Average jackpot increased by 65.3%.
- This significant jackpot growth is attributable to a matrix change.
- Worsened the odds of any player winning the jackpot...fewer winners...higher jackpots...higher sales.

# POWERBALL - continued

- Majority of last year's sales growth should be seen as “one-time” growth (attributable to the matrix change).
- Average sales BEFORE the matrix change: \$2.9 million per week (142 drawings...04/21/04 → 08/27/05).
- Average sales AFTER the matrix change: \$3.6 million per week (134 drawings...08/31/05 → 12/09/06).
- Growth that we experienced was not natural growth.
- So far this FY the jackpot has averaged \$71.0 million; which is down about 13.7%.
- As a result, sales have been down.
- July thru November (2006) sales are down about 16.5% (relative to the same time period in 2005).
- Will this continue? It all depends on the jackpots!

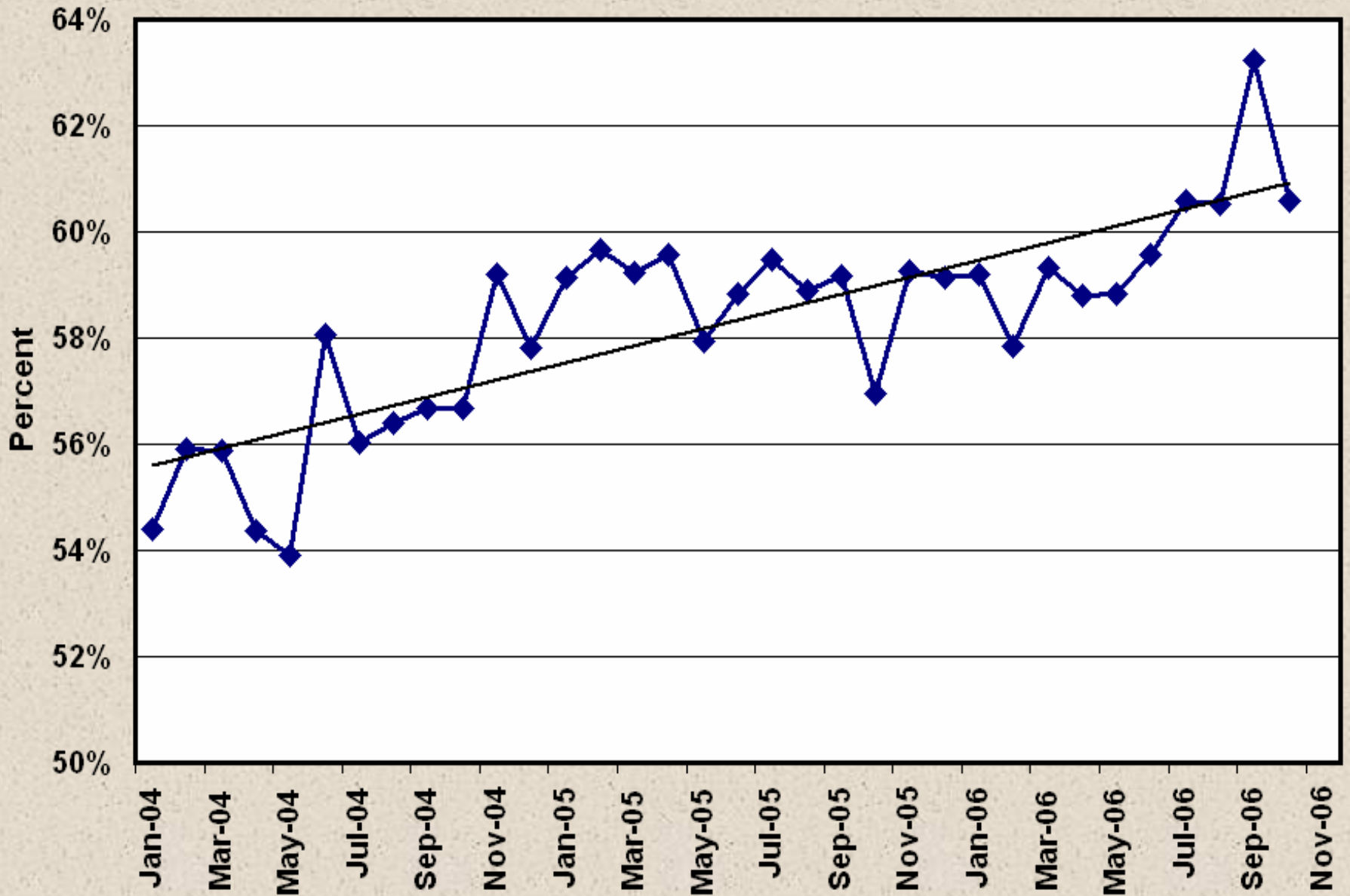
# New Games

- New online game is called “HotTrax Champions”.
- Terminal-based game located in social establishments (bars, restaurants, etc...).
- *NASCAR* racing theme.
- Introduced on November 20, 2006.
- Available for about 32 of 52 weeks during FY06-07.
- Another new game introduction is expected in Q1 of calendar year 2007.
- Raffle-type game with a fixed number of tickets.
- Expectation: generate between \$12.5 to \$14.2 million in new revenue for FY06-07.

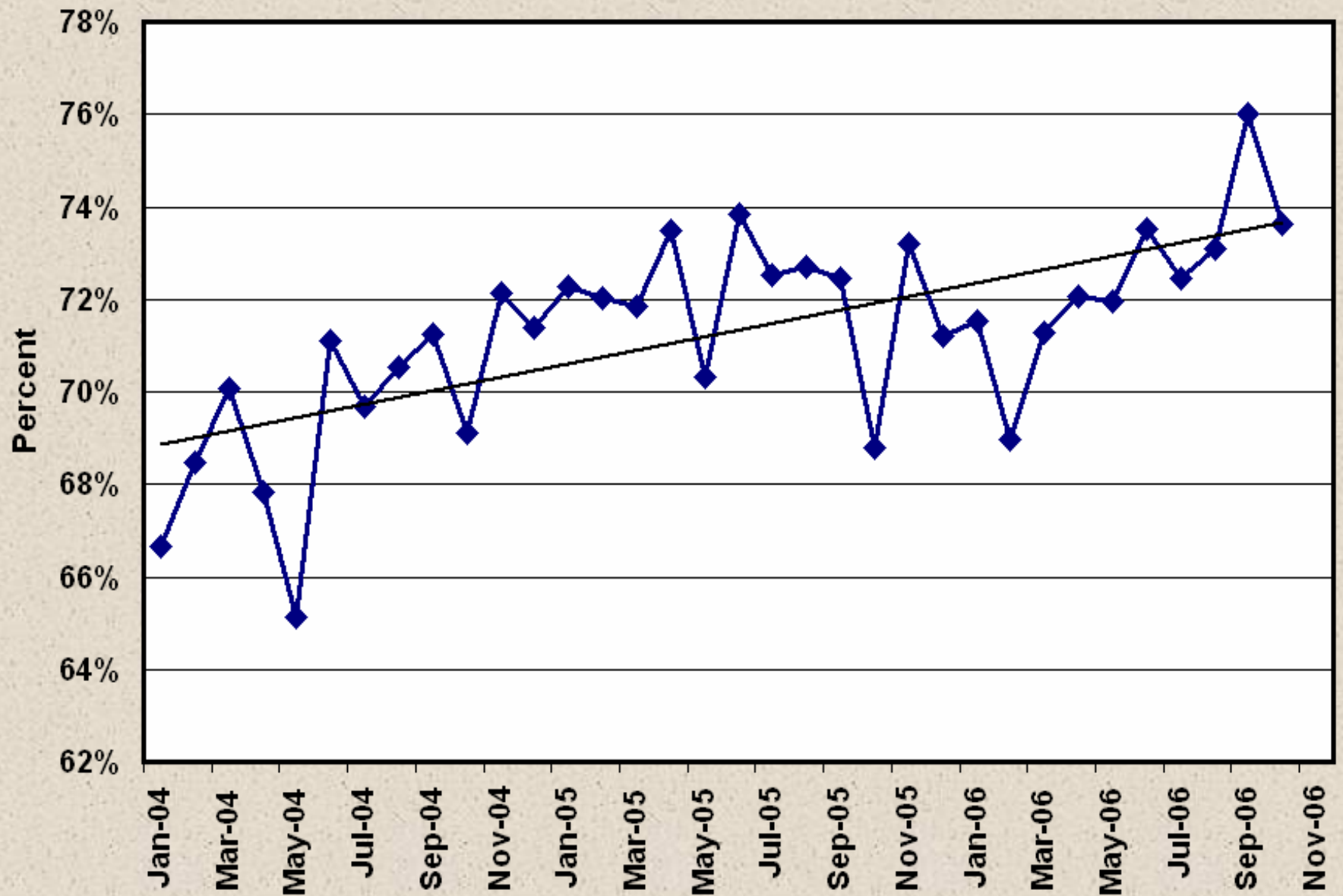
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# Trends - Expenses & Net Lottery Proceeds

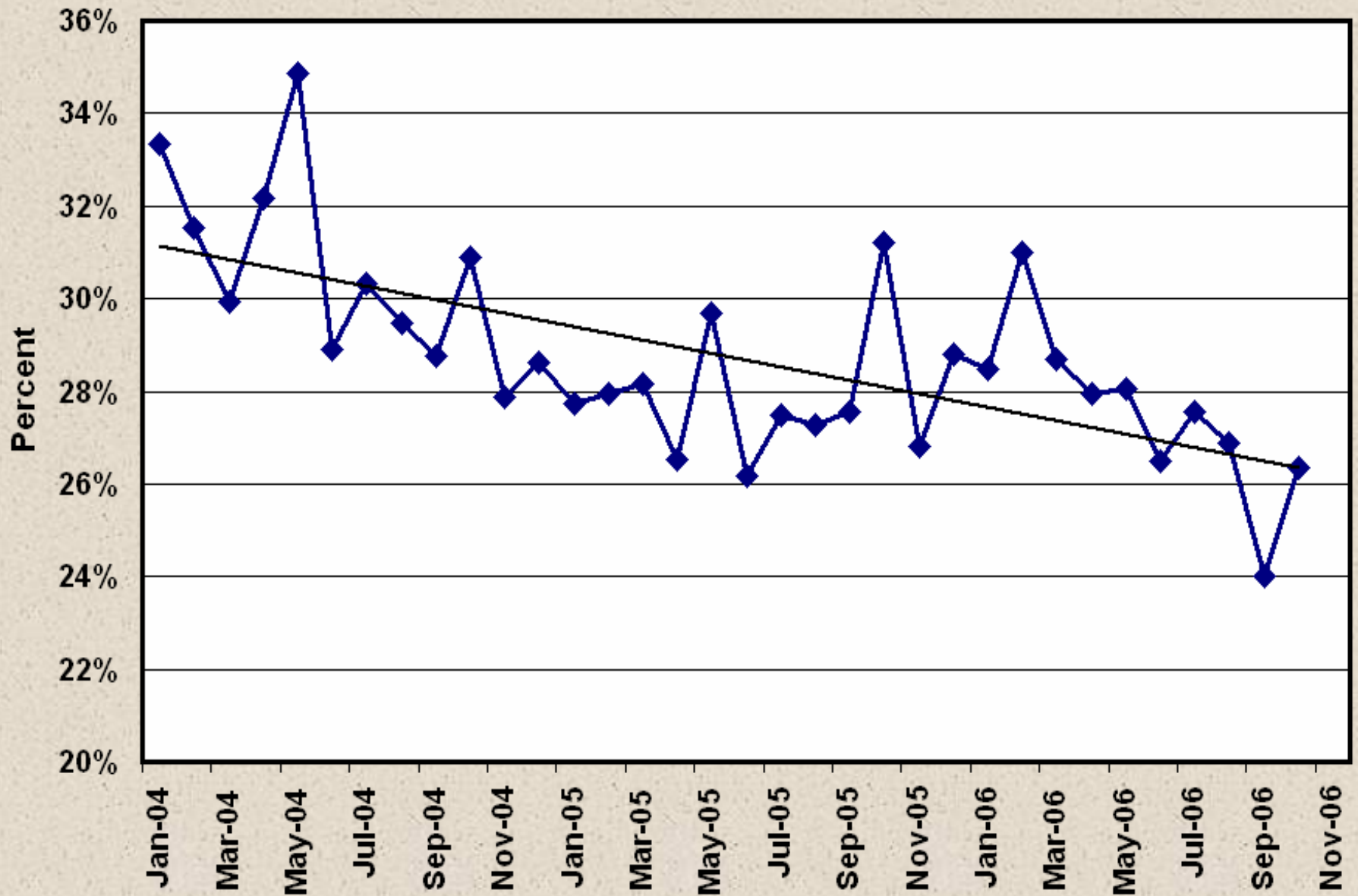
*Prize Expense (As a Percent of Net Ticket Sales)*



*Total Expenses (As a Percent of Net Ticket Sales)*



*Net Lottery Proceeds (As a Percent of Net Ticket Sales)*

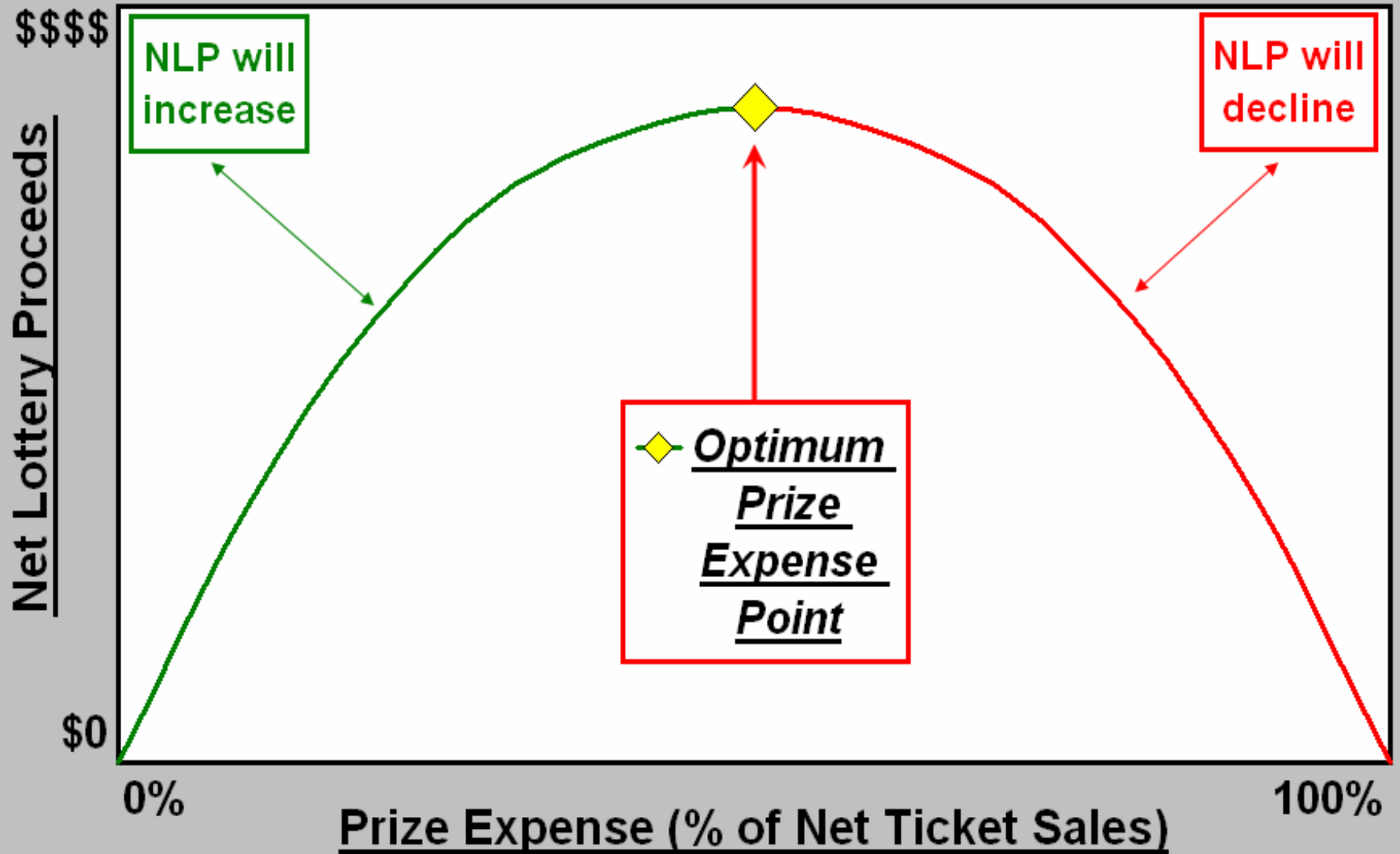




# Conclusion

- Does not necessarily mean net lottery proceeds (NLP) are decreasing.
- NLP could be increasing or decreasing.
- It all depends on the extent of *sales growth*.
- If sales grow at a rate sufficient that the incremental revenue exceeds the incremental prize expense...then NLP (dollars) will increase.
- If sales decline or grow at some rate that does not cover the incremental prize expense...then NLP (dollars) will decrease.
- Caution: Perpetual prize payout increases, year-over-year, increases the probability that NLP could turn negative at some point (law of diminishing returns).

## Optimum Prize Expense Point



# Overall Expectation

- Where are we on this curve?
- Still to the left of the optimum prize expense point.
- Confirmed by good instant game growth.
- But, the IG growth is starting to “diminish”...
- ...Last year = 16.6%; so far this year = 11.2%.
- Still good growth opportunities.
- Last year's growth of total net sales = 18.4%.
- So far this year = 5.8%.
- Expected growth range of net sales this year: between 5% and 9%...(7.2% median).
- What could alter this?

# Assumptions

- No matrix changes will occur to the pari-mutuel games (Powerball and Lotto 5) during FY06-07 or FY07-08.
- Drawing frequencies will remain unchanged for the pari-mutuel and online games during FY06-07 or FY07-08.
- No new game introductions will occur in FY06-07 or FY07-08 outside the ones already discussed.
- Sales for the pari-mutuel games (PB, L5) have been estimated using average jackpot cycles.
- FY07-08 estimates assume 2.5% overall net sales growth.
- Total Expense ratio is 73% of net revenues.
- Net Lottery Proceeds ratio is 27% of net revenues.

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# **FY06-07 Estimates**

## **(as of May 3, 2006)**

**RANGE ESTIMATES FOR FY06-07 (as of 05/03/06)**

Revenue Source	Lower	Median	Upper
Instant Games (Net)	\$635,118,000	\$639,693,000	\$647,556,000
Cash 3	\$62,508,000	\$62,753,000	\$62,999,000
Powerball	\$193,067,000	\$200,207,000	\$207,347,000
Lotto 5	\$21,478,000	\$21,707,000	\$21,936,000
Cash 4	\$26,190,000	\$26,296,000	\$26,402,000
<b>NET TICKET SALES</b>	<b>\$938,361,000</b>	<b>\$950,656,000</b>	<b>\$966,240,000</b>
Misc. Revenue	\$4,998,000	\$5,100,000	\$5,202,000
<b>TOTAL NET REVENUE</b>	<b>\$943,359,000</b>	<b>\$955,756,000</b>	<b>\$971,442,000</b>
<b>Expenses at 72%</b>	<b>\$679,218,000</b>	<b>\$688,144,000</b>	<b>\$699,438,000</b>
<b>Net Lottery Proceeds at 28%</b>	<b>\$264,141,000</b>	<b>\$267,612,000</b>	<b>\$272,004,000</b>

# FY06-07 Estimates (Revised)

**RANGE ESTIMATES FOR FY06-07 (as of 12/15/06)**

<b>Revenue Source</b>	<b>Low</b>	<b>Median</b>	<b>High</b>
<b>Instant Games (Net)</b>	<b>\$680,851,000</b>	<b>\$689,957,000</b>	<b>\$694,714,000</b>
<b>Cash 3</b>	<b>\$63,706,000</b>	<b>\$64,369,000</b>	<b>\$65,205,000</b>
<b>Cash 4</b>	<b>\$25,030,000</b>	<b>\$25,287,000</b>	<b>\$25,516,000</b>
<b>Lotto 5</b>	<b>\$26,330,000</b>	<b>\$26,932,000</b>	<b>\$27,533,000</b>
<b>Powerball</b>	<b>\$162,193,000</b>	<b>\$174,770,000</b>	<b>\$187,348,000</b>
<b>Hottrax Champions</b>	<b>\$5,565,000</b>	<b>\$5,855,000</b>	<b>\$6,145,000</b>
<b>Other New Game</b>	<b>\$7,000,000</b>	<b>\$7,500,000</b>	<b>\$8,000,000</b>
<b>NET TICKET SALES</b>	<b>\$970,675,000</b>	<b>\$994,670,000</b>	<b>\$1,014,461,000</b>
<b>Misc. Revenue</b>	<b>\$5,400,000</b>	<b>\$5,500,000</b>	<b>\$5,600,000</b>
<b>TOTAL NET REVENUE</b>	<b>\$976,075,000</b>	<b>\$1,000,170,000</b>	<b>\$1,020,061,000</b>
<b>Expenses at 73%</b>	<b>\$712,535,000</b>	<b>\$730,124,000</b>	<b>\$744,645,000</b>
<b>Net Lottery Proceeds at 27%</b>	<b>\$263,540,000</b>	<b>\$270,046,000</b>	<b>\$275,416,000</b>



# FY07-08 Estimates (New)

**RANGE ESTIMATES FOR FY07-08 (as of 12/15/06)**

<b>Revenue Source</b>	<b>Low</b>	<b>Median</b>	<b>High</b>
<b>Instant Games (Net)</b>	<b>\$700,596,000</b>	<b>\$709,966,000</b>	<b>\$714,861,000</b>
<b>Cash 3</b>	<b>\$64,025,000</b>	<b>\$64,691,000</b>	<b>\$65,531,000</b>
<b>Cash 4</b>	<b>\$24,780,000</b>	<b>\$25,034,000</b>	<b>\$25,261,000</b>
<b>Lotto 5</b>	<b>\$26,330,000</b>	<b>\$26,932,000</b>	<b>\$27,533,000</b>
<b>Powerball</b>	<b>\$163,815,000</b>	<b>\$176,518,000</b>	<b>\$189,221,000</b>
<b>Hottrax Champions</b>	<b>\$8,869,000</b>	<b>\$9,331,000</b>	<b>\$9,794,000</b>
<b>Other New Game</b>	<b>\$7,000,000</b>	<b>\$7,500,000</b>	<b>\$8,000,000</b>
<b>NET TICKET SALES</b>	<b>\$995,415,000</b>	<b>\$1,019,972,000</b>	<b>\$1,040,201,000</b>
<b>Misc. Revenue</b>	<b>\$5,400,000</b>	<b>\$5,500,000</b>	<b>\$5,600,000</b>
<b>TOTAL NET REVENUE</b>	<b>\$1,000,815,000</b>	<b>\$1,025,472,000</b>	<b>\$1,045,801,000</b>
<b>Expenses at 73%</b>	<b>\$730,595,000</b>	<b>\$748,595,000</b>	<b>\$763,435,000</b>
<b>Net Lottery Proceeds at 27%</b>	<b>\$270,220,000</b>	<b>\$276,877,000</b>	<b>\$282,366,000</b>